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IN THE

Supreme Court of the United States

October Term, 1938

No. 169

THE UNITED STATES,
Petitioner

v.

FREDERICK PLEASANTS

ON A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

SUPPLEMENTAL BRIEF FOR RESPONDENT

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The above case was argued before this Honorable Court on December 5, 1938. On that day, *White et al.* v. *U. S.*, Nos. 96, 97, was decided. That case held that upon a liquidation of a corporation stockholders' losses from their investment in its stock held for more than two years are not ordinary losses deductible in full, but are capital losses, the deductibility of which is limited by Section 101. On page 2 of the opinion, it is stated in part as follows:

> "These provisions of Sec. 23 are qualified and restricted by Sec. 101, which prescribes rates of tax applicable to capital net gains and the extent to which capital net losses are deductible in arriving at net taxable income. * * *."

Capital losses are deductible from capital gains in arriving at capital net gain, as defined by Section 101 (c) (5), subject to the 12½% tax. A capital net gain is the excess of the gains over losses. Capital losses are deductible to the extent of the capital gains, but the excess of the losses over gains, is a capital net loss within the meaning of that term as defined by Section 101 (c) (6), and such a net loss is not a permissible deduction under Section 23 (e). *Piper* v. *Willcuts*, (CCA 8), 64 F. (2d) 813, affirming 55 F. (2d) 397; *Hoffman* v. *Commissioner*, (CCA 2), 71 F. (2d) 929. In *Piper* v. *Willcuts*, supra, it was expressly recognized that a capital net loss is not a permissible deduction under Section 214 (a) (4) and (5) of the Revenue Act of 1926, which is similar to Section 23 (e) of the Revenue Act of 1932, in computing the taxpayer's net income, and *White et al* v. *U. S.*, is in harmony therewith. The general statutory concept of net income is covered by Sections 21, 22 and 23, but the general provisions of Sections 22 and 23 are subject to the special provisions of later sections in the Act forming part of Title I. Section 23 (e) is also subject to the limitation provisions of Section 118, loss from wash sales of stock or securities. Section 23 (e) of the Revenue Act of 1936 is also subject to the limitation contained in Section 24 (a) (6), as amended by Section 301 (a) (b) of the Revenue Act of 1937 disallowing losses from sales or exchanges of property between members of a family.

In the case at bar, the Commissioner determined the taxpayer's net income subject to the normal and surtaxes to be $94,963.52, and in the computation of that net income no deduction was allowed for the capital net loss of $154,921.98. We concede this to be correct under the statute, except for the deduction for contributions. We claim that contributions of

$3,496.00 should be deducted from $94,963.52, the provisional net income without contributions, and that $91,467.52 is the correct final net income subject to the normal and surtaxes. The question is very narrow. A taxpayer's total net income subject to tax, as computed without the benefit of the deduction for contributions, is the taxpayer's base as contemplated by Congress in Section 23 (n), because Congress intended to relieve from taxation income devoted to charity, and in order to effectuate that policy taxable net income is the measuring rod. It would be improper to use as a base an amount which is not net income subject to tax.

Our views are in entire harmony with *Helvering v. Bliss*, 293 U. S. 144. In that case, Mrs. Bliss had a total net income subject to tax of about $500,000, consisting of ordinary net income subject to the normal and surtaxes of $289,000 and capital net gain subject to the 12½% tax of $211,000. This Court held that the base under Section 23 (n) for calculating the 15% limitation was the total net income of $500,000 and that it was improper for the Commissioner to confine the 15% to the ordinary net income of $289,000.

We now have a case here where the taxpayer's total net income subject to tax consists entirely of his ordinary net income of $94,963.52, as computed without a deduction for contributions. Section 101 (c) (7) defines ordinary net income to mean the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions. The language of exclusion excludes a capital net gain or loss. Ordinary net income is net income computed in accordance with the general provisions of Sections 21, 22 and 23, as modified by Section 101 or any other provision forming a part of "this title," being Title I.

If $94,963.52 were not net income within the meaning of that term as used in Section 21, how could it be taxed as net income under Sections 11 and 12? Under the express mandate of Section 101 (c) (7) the net income must be computed in accordance with the provisions of "this title." Congress denominated ordinary net income as net income in order to enable the imposing provisions of Sections 11 and 12 to work. The provisions of the statute mesh when given a fair and reasonable interpretation in harmony with the legislative purposes. Prior to 1924, a taxpayer's losses sustained on sales were deductible in full, in consequence of which many taxpayers escaped income taxes altogether or greatly reduced the same. Congress by Section 101 of the 1924 Act prohibited the deduction of a capital net loss, the excess of losses over gains, in the same manner as Section 23 (r) prohibits the deduction of the excess of losses over gains on sales of securities held less than two years. Congress did not want a taxpayer to get the benefit of the net loss in computing net income subject to tax, and in that way, a taxpayer's net income was enlarged, and he had to pay more tax. The legislative history is clear. See report of Mr. Green, Chairman, Committee on Ways and Means, 68th Cong., 1st Session, Report No. 179, and his statement on the floor of the House in explanation of the capital net loss provisions. Vol. 65 Congressional Record, Part 3, 68th Congress, 1st Session, page 2428. Judge Green, the Chairman referred to, took part in the consideration and decision of the case at bar.

In the *Bliss* case, supra, it was held that the deduction for contributions was an ordinary deduction to be taken from ordinary net income. The taxpayer's statutory net income here consists entirely of his ordinary net income, and if contributions are deductible in computing ordinary net income in a capital

net gain case, which was the *Bliss* case, they are deductible in computing ordinary net income in a capital net loss case, because the term ordinary net income appearing in the statute means the same thing in each type of case.

Final net income means the base for calculation of the tax, as was held in the *Bliss* case, and that base in the instant case as computed without contributions is $94,963.52. A taxpayer who has a statutory net income for the calculation of the tax has a base under Section 23 (n), otherwise the evident purpose of Congress to encourage contributions is thwarted or defeated. The taxpayer here has been compelled to pay a tax on income which he gave to charity. Congress intended that it should be exempt from tax.

Respectfully submitted,

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December, 1938.